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DEPARTMENT OF STATE

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Memorandum of Conversation

DATE: November 8, 1967

SUBJECT: Study of Indonesian Debt Rescheduling and Assistance Requirements

PARTICIPANTS: Deputy Assistant Secretary Robert W. Barnett, EA

Mr. William Morell, Director, Office of Economic Research, CIA
Mr. John Colman, Director, Office of International Monetary Affairs, E/OMA

Mr. Roger S. Lowen, International Economist, EA/IND

COPIES TO:

American Embassy, DJAKARTA

Mr. J. Mark Dion, INR

Mr. Barnett said he wished to discuss an important, even urgent, matter concerning debt rescheduling and foreign assistance for Indonesia. These problems should be analyzed particularly because they could play a part in the President's forthcoming State of the Union Message. He wished to emphasize, however, that the studies for which he was requesting Mr. Morell's assistance should not be designed as policy recommendations, but rather as clarification of the issues.

Mr. Barnett continued that Mr. Colman's office, the Desk, the IMF and the DAC had all done considerable work on the balance of payments effects of debt servicing by Indonesia over the next 15 years. These studies contained high and low estimates and other variables. There was no

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lack of numbers and all the studies approached the problem with a slightly different notion of what to do. It is apparent that the IMF expects Indonesia's balance of payments prospects will require a sizable aid input if the GOI is to move into the developmental stage from the present stabilization stage. The IMF projections assume that exports will increase at an arithmetic rate of some 4 - 5 per cent per year. He was somewhat more sanguine over Indonesia's export prospects as a sudden breakthrough in a field such as oil could lead to dynamic changes in earning potential.

What he needed to know, Mr. Barnett emphasized, was who is planning to do what for the Indonesians in the form of debt rescheduling and foreign assistance for the next 20 years - through 1987. This was particularly important because debt rescheduling is in effect untied aid because of the fungible nature of the assistance rendered. If we can obtain an idea of who, when, and to what extent fresh grant and loan aid is made available, then we can analyze the true effect of such aid. As an example, Mr. Barnett cited the case of Italy. Given Italy's significant creditor position vis-a-vis Indonesia and given its relatively small foreign assistance input, Italy would get a free ride after 1971 as a result of receiving loan repayments actually financed from other countries new assistance. Mr. Colman cited the case of Turkey where this effect had become so pronounced that the U.S. was now the only real donor while the other "participants" had actually become beneficiaries.

Continuing, Mr. Barnett pointed out that the mix of debt servicing under rescheduling arrangements plus the servicing of new debts incurred by the government from aid plus the servicing of private loans covered by government guarantees could impose on the GOI an aggregate debt burden in 1977 and beyond of from 30 to 40 per cent or more of projected foreign exchange earnings. Mr. Colman accentuated this point by stating that Indonesia was accumulating new debts at the rate of \$200 to \$300 million per year. Mr. Barnett suggested that once the grace period ended, countries currently providing aid would have a hard time explaining to their legislative bodies why they should continue to provide foreign aid to service the debts of those countries lagging in providing foreign assistance to Indonesia. In this connection, he stressed that we must have a clear picture of the debt and repayment profile of both the non-Communist countries and the Communist countries.

As we will be, in all likelihood, shy of aid resources during 1968

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and 1969, these above problems have tremendous operational relevance. It appears that pressure is building at the highest levels of our government to consider supplementary legislation for aid to Indonesia. Mr. Barnett thought that the data to be developed by Mr. Morell might very well reveal possibilities for the Congress to authorize writing off a major part of the Indonesian debt. He suggested that this might be particularly applicable to the large debts incurred by President Sukarno and he opined that perhaps the Indonesians could pay these debts on the basis of some formula such as 10 cents on the dollar. Of course, such legislative authority would probably be dependent upon the agreement of other major creditors such as Japan, the USSR and the European creditors to do likewise. This action could have tremendous appeal to Congress as it could thus provide Indonesia with a large degree of relief without additional expenditures of current resources.

Concluding, Mr. Barnett emphasized that he wants the White House to realize that this is a possibility. Action would be difficult because of the lack of a precedent, but conversely some would like to establish this new precedent. Mr. Morell said he would get in touch with Messrs Colman and Lowen and would use his staff to prepare the relevant studies.

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<p>Dick: There are a couple of problems associated with this study which I have discussed with the Staff. However, we believe we can prepare a paper by the middle of December that will shed some light on Barnett's questions.</p> <p style="text-align: right;">Bill Morell D/OER</p> <p><i>Proj. 46.5142 - due 15 Dec.</i></p>			
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MEMORANDUM FOR: D/OER

The attached Memorandum of Conversation of your meeting with Mr. Barnett on 8 Nov 1967 was given to me today by Mr. Colman. It covers all of the items I would have included in a Memo for the Record.

We agreed today with Mr. Colman to prepare an outline of our study for Mr. Barnett. On 17 Nov, Mr. Colman will meet with us again here to finalize the outline. We informed Mr. Colman our study will be completed the first or second week in December.


Chief, D/FW

13 Nov 67
(DATE)